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March 14, 2003

Mr. R. Richard Newcomb
Director
Office of Foreign Asset Controls.
Department of the Treasury
1500 Pennsylvania Avenue, N. W., 2nd floor
Washington, D.C. 20220

Re: Proposed OF AC Enforcement Guidelines

Dear Mr. Newcomb:

Enclosed for your information is a copy of the comments that I am filing today with OF AC's Chief of Records on the Proposed Economic Sanctions Enforcement Guidelines that were published for comment January 29,2003.

Although I believe the proposed Guidelines can be improved in certain respects as set forth in the comments, your staff has done an exceptional job in developing this important and well-conceived document. I am particularly pleased that it was published in proposed form for public comment.

Enclosure

cc with enclosure:
Chief Elizabeth Scott, Civil Penalties Division
Chief David Mills, Licensing Division Chief
Counsel Barbara Hammerle

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March 14, 2003

Chief of Records
Office of Foreign Assets Control,
Department of the Treasury 1500
Pennsylvania Avenue, N. W.
Washington, DC 20220

Re: Request for Comments -Proposed Economic Sanctions Enforcement Guidelines (68 Fed. Reg. 4422 (Jan. 29, 2003))

Dear Sir or Madam:

This letter offers constructive comments regarding the proposed updated Economic Sanctions Enforcement Guidelines (the "Enforcement Guidelines") that were published for comment in the Federal Register for January 29, 2003. In general the proposed Enforcement Guidelines would represent an important step forward for the Office of Foreign Assets Control ("OFAC") in its on-going efforts to provide increased transparency and consistency in the administration of its sanctions programs, consistent with the recommendations made two years ago by the Judicial Review Commission on Foreign Asset Control.

The proposed Enforcement Guidelines also represent a major advance over the prior non-public version that was published in an appendix to the Commission's report. In particular, they address the conditions under which warning letters will be considered appropriate to resolve enforcement cases. And, where civil penalties are envisioned, they provide greater specificity in terms of the mitigating and aggravating factors to be considered in determining the amount of the penalty and they quantify the amount of mitigation with respect to two of the most common mitigating factors -voluntary disclosure and first offense.

These clarifications should facilitate voluntary disclosures and contribute to the negotiation of agreed settlements. However, several aspects of the proposed Enforcement Guidelines could be amplified, further clarified or revised to provide more equitable treatment and better understanding of OFAC' s enforcement process. The comments that follow are intended to provide constructive suggestions to improve these very useful Guidelines.

A. Cautionary and Warning Letters

The proposed Enforcement Guidelines state that "cautionary letters" may be issued to financial institutions in appropriate circumstances where there is insufficient evidence to conclude that a violation has occurred but activity indicating that a violation could occur in the future; or when a financial institution appears not to be exercising due diligence in assuring compliance with sanctions, There appears to be no reason why OF AC should not issue cautionary letters in appropriate situations involving parties other than financial institutions where, for example, it "appears that a party's compliance program is not effective or might lead to future violations. 'For this reason the language under the heading "Cautionary Letters" should be clarified to indic ate that this treatment is applicable generally, not only to financial institutions but to all entities and individuals whose conduct is subject to sanctions proscriptions.

The proposed Enforcement Guidelines state that warning letters may be issued in OFAC's discretion, where OFAC has determined that an apparent sanctions violation has occurred but that such a letter may achieve the same result as a monetary penalty insofar as future sanctions compliance is concerned. The Enforcement Guidelines then provide eight examples of situations deemed appropriate for disposition by warning letters in the context of "financial transfers," and one situation deemed so appropriate for "exports and imports," Specifically, the only situation involving "exports and imports" that is identified as appropriate for the issuance of a warning letter is one where the transaction value is $500 or less and there are no aggravating circumstances. If the violation is neither a "financial transfer" nor an "export or import," there is no example of when a warning letter may be issued, and one may draw the inference that a warning letter disposition is never appropriate,

There is a justification for highlighting financial transfers in the context of warning letters because, as the proposed Enforcement Guidelines observe, the volume of such transactions is large and these can only be screened effectively for enforcement purposes through automated procedures in which technical failures or clerical oversight may occasionally take place. However, a reading of the eight "financial transfers" warning letter disposition examples indicates that a number of the described situations would find exact or near equivalence in the context of "export or import" or other transactions not involving financial transfers, e.g., transactions involving mis-identification of blocked parties, transactions resulting from clerical errors, transactions involving newly-designated blocked parties, transactions that would have been eligible for licensing under applicable policies, and other transactions where the fact pattern and underlying transaction would make the issuance of a warning letter an appropriate disposition.

The circumstances when warning letter dispositions may be appropriate should be broadened to cover all of these situations, whether the violation involves a financial transfer or some other type of transaction, Of course OF AC would retain discretion to determine

whether or not a warning letter is an appropriate disposition in the light of all the relevant circumstances.

B. Starting Point for the Calculation of Civil Penalties

The proposed Enforcement Guidelines indicate that where it has been determined that a sanctions violation has occurred and that a warning letter is not appropriate, a civil penalty will be calculated by first determining a "proposed penalty" and then applying mitigating or aggravating factors to decrease or increase the proposed penalty. The proposed penalty is determined differently according to the nature of the violation. For this purpose, six categories of violations are identified - dealings in blocked property and funds transfers, exports and imports, contract performance and new investment, travel-related violations, services-provider violations, and reporting and record-keeping violations. The last three of these categories present unique situations that are beyond the scope of these comments.

The striking difference among the first three of the identified categories is that the "proposed penalty" for the first and third is stated to be the lesser of the transaction value or the statutory maximum penalty, whereas for the second category -exports and imports -it is stated that the "proposed penalty" will be the transaction value -the value of the exported or imported goods, technology or services -without mention of the alternative statutory maximum penalty. This dichotomy may be a simple drafting error oversight in the proposed Enforcement Guidelines. If the intention is to make the "proposed penalty" more severe for export and import violations than for financial transfers, dealings in blocked property and contract performance, no justification for such a distinction is given and none is apparent. The proposed Enforcement Guidelines should be revised so that, for the second category -exports and imports -the "proposed penalty" will not be greater than the maximum statutory penalty.

It would not be sufficient simply to state that the penalty ultimately determined for an export or import violation may not exceed the statutory maximum. Under the proposed Enforcement Guidelines the ultimate penalty is determined after application of mitigating and aggravating circumstances to the "proposed penalty." Failure to set the "proposed penalty" for export and import violations at the lesser of the transaction value or the statutory maximum could wholly or partially vitiate the effects of mitigation. For example, if the transaction value and proposed penalty were $50,000 and the statutory maximum were $11,000, and if the 50% voluntary disclosure mitigation were applied to the former figure, the ultimate penalty would be the statutory maximum, and the mitigation would have no effect. This formula certainly would not encourage voluntary disclosures for export or import violations and would make the penalties for these violations potentially greater than those for financial transfers and contract performance or new investment.

In the case of violations associated with contract performance or new investment it is stated that the "proposed penalty" will be the lesser of the statutory maximum "or the value of the contract or investment." It is unclear how such values will be calculated. In particular, the stated or face value of the contract or investment appears not to be the appropriate standard if the contract or investment is less than complete, especially if the U.S. person has ended performance upon the discovery of a violation. In such circumstances, the "proposed penalty" should not be in excess of the value of the goods and services that in fact have been transferred, as contrasted with what may have been agreed to or contemplated had the contract or investment undertaking. been fully performed.

Not addressed in the proposed Enforcement Guidelines is how OF AC will determine the number of violations that may be associated with a particular transaction or course of dealing in determining the "proposed penalty." In contrast to some federal agencies that sometimes have been prone to "parse" transactions in order to create multiple violations justifying larger penalties, my experience with OF AC is that it has not followed such dubious practices, e.g., by breaking a single transaction into pieces to achieve multiple violations. This established practice should be confirmed in the Enforcement Guidelines, e.g., by stating that, absent unusual circumstances, OF AC will consider each integral transaction to constitute no more than a single violation.

Somewhat more difficult to address is the appropriate treatment of transactions of the same character that are caused by a single oversight or compliance failure. Perhaps such situations are most effectively addressed by a mitigation policy that justifies a reduction in the aggregate proposed penalty by reason of such circumstances. It would be appropriate to incorporate such a policy in the Enforcement Guidelines, e.g., by recognizing such circumstances as a situation justifying mitigation, although probably not quantifiable in percentage terms.

C. Quantification of Mitigating and Aggravating Factors

The proposed Enforcement Guidelines identify a number of mitigating and aggravating factors to be taken into account to adjust the "proposed penalty" for purposes of settlement or to assess a penalty. Two of the potential mitigating factors are quantified, i.e., the proposed penalty is to be mitigated by at least 50% for a voluntary disclosure and by at least 25% for a first offense. I assume this means that the proposed penalty would be mitigated by at least 75% in a situation where the violation is a first offense and is voluntarily disclosed (rather than by applying the 50% reduction to the proposed penalty and the further 25% reduction to the remainder), but it would be helpful to clarify that this is the intention. By contrast, in the case of a second violation not only is the presumptive 25% mitigation lost

but the violation is treated as an aggravating factor. This appears to be double counting. It would be more equitable to recognize the presence of an aggravating circumstance only for the third or subsequent violation.[1]

The proposed Enforcement Guidelines also are unclear as to what qualifies as a "first offense" when multiple violations are presented in a single disclosure or developed in a single investigation, but where no prior violations have occurred. My view would be that the 25% reduction should apply to all violations encompassed in such a single disclosure or proceeding, provided there is no evidence that multiple violations were held back from earlier disclosure for the purpose of obtaining such a reduction. A significant objective of the policy to reduce penalties for first offenses is to encourage voluntary disclosure, and that objective would be diminished if only the "first" violation disclosed as part of a single submission qualified as a "first offense." If OF AC agrees with this reasoning, the Guidelines should explicitly so state.

The Guidelines state explicitly that negotiated settlements do not constitute a determination that any violation has occurred, and that, in determining whether an apparent violation constitutes a first or subsequent offense, "a distinction generally will be made between prior OF AC penalty cases ending in an assessed civil monetary penalty and those settled prior to finding of a violation." The reasonable inference from this language is that a negotiated settlement will not deprive the settling party of the opportunity to mitigate a later charge as a "first offense" and likewise to avoid having the later charge aggravated by reason of the existence of a prior violation. The proposed Guidelines should make this inference explicit. The ability to avoid treatment as a "second offender" is a powerful inducement to negotiate a settlement of proposed or possible charges, and it is in the interest of both the government and the private sector to negotiate mutually satisfactory settlements wherever feasible.

Finally, some potentially significant mitigating circumstances are not listed in the proposed Enforcement Guidelines. These include the circumstances enumerated in the description of eligibility for "Warning Letters" earlier in the Guidelines (including clerical errors and oversights and activities eligible to be licensed), where the judgment is that from an overall standpoint the matter is not appropriately resolved by a warning letter. Other mitigating circumstances that usefully could be enumerated in the Guidelines include meaningful cooperation during an OF AC investigation, whether or not initiated by a

! Although not quantified in the Guidelines, similar "double counting" appears to exist in the listing of aggravating counterparts of mitigating factors, e.g., presence (vs. absence) of a compliance program; and remedial measures taken (vs. not taken) after discovery of an apparent violation.

voluntary disclosure;[2] the absence of significant detriment to OFAC program objectives;3 and the absence of significant economic benefit to the party responsible for the apparent violation. For example, it is not uncommon that a particular foreign export transaction in apparent violation ofa sanctions proscription may have resulted in an economic loss or very little profit to the U.S. transaction party, even though the "transaction value," as determined by the Enforcement Guidelines, is substantial and constitutes the "proposed penalty" under the Guidelines formula. Failure to recognize that the transaction did not give rise to a significant profit, or resulted in a loss, could result in an excessive penalty.

D. The Settlement Process

The proposed Enforcement Guidelines contemplate that potential violations may be settled by agreement either prior to or after the issuance of a pre-penalty notice. To negotiate a settlement prior to the issuance of such a notice, the party in question may request that OF AC withhold the notice for up to 60 days "for the exclusive purpose of reaching a settlement."

One difficulty with this formulation is that it is not clear how the party in question is made aware of the prospect of the issuance of a pre-penalty notice in order to be in a position to request the opportunity to negotiate a settlement. As a matter of fundamental fairness and due process, the formulation should state that before OF AC issues a pre-penalty notice it will so notify the party to which the notice is to be addressed, and afford that party a specified reasonable period of at least 60 days to negotiate a settlement.4 OF AC should reserve its flexibility to specify a period longer than 60 days where this appears to be more appropriate, e.g., in more complex cases or where there are multiple parties, foreign parties, or other

[2] Explicit reference is made to one aspect or possible result of such investigation, which is the development of "useful enforcement information during an OF AC audit," but this description may include only OF AC-initiated audits and in any case is too narrow to include all aspects of cooperation in all possible circumstances.

[3] This aspect is dealt with in the Enforcement Guidelines only in a negative sense, e.g., as an aggravating circumstance where there is an "extraordinary adverse economic sanctions impact" by reason of the violative activity.

[4] It would facilitate early settlement if this initial OFAC notice were to specify the apparent violations OF AC intends to cite in the ensuing pre-penalty notice and the penalty amount likely to be specified therein, taking into account disclosed mitigating circumstances, including voluntary disclosure and/or first offense. These important threshold considerations are included under the heading "Settlement Process" in the proposed Guidelines but more effectively would be presented in the initial notice creating the opportunity for an early settlement.

circumstances justifying a longer period. OF AC also should preserve the option to extend the specified settlement negotiating period for good cause, either through its own initiative or at the request of the party or parties involved.

E. Penalty Assessments in the Absence of a Negotiated Settlement

The proposed Enforcement Guidelines fail to acknowledge that in the case of alleged violations of the provisions of the Cuban Assets Control Regulations issued under the authority of the Trading with the Enemy Act the respondent in a civil enforcement proceeding is entitled to request an administrative hearing before an administrative law judge before any civil penalty is imposed other than pursuant to a negotiated settlement.[5]

Conclusion

These comments are submitted to assist OFAC in formulating the final version of the Enforcement Guidelines. They are not submitted on behalf of any client of Covington & Burling.

Although the proposed version of the Guidelines can and should be improved in particular respects as here suggested, this does not in any way diminish the fact that the Guidelines represent a significant step forward in OFAC's progress to make its proceedings more transparent and its enforcement actions more consistent. If the author of these comments can be of further assistance in this effort, he would be pleased to do so, and any member of the OFAC staff should feel free to contact the undersigned (tel. 202-662-5530).

Courtesy copies of these comments are being provided to OFAC Director Richard Newcomb, Civil Penalties Division Chief Elizabeth Scott, Chief Counsel Barbara Hammerle, and Licensing Division Chief David Mills.

John Ellicott

Senior Counsel
Covington & Burling

[5] *See* 31 C.F.R. § 515.705.